

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 98-0558 ST
SALES AND USE TAX
For Tax Periods: 1995 Through 1997**

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Issue

Sales and Use Tax-Manufacturing Exemption

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3, IC 6-8.1-5-1 (b), 45 IAC 2.2-5-8 (d), *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948).

The taxpayer protests the assessment of tax on three items.

Statement of Facts

The taxpayer is engaged in the processing of food products that it sells to a major fast food chain. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest and penalty after an audit. The taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

Sales and Use Tax-Manufacturing Exemption

Discussion

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used or consumed in Indiana. A number of exemptions are available from use tax. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property."

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer protests the assessment of tax on a laser printer, a conveyor belt, and the flour corn used during packaging of the product.

The law sets out a two pronged test to determine whether an item qualifies for exemption. First, exempt items must be used during the production process. Secondly, exempt items must directly affect the production of the product.

The first issue to be determined is whether or not the protested items are used during or after the production process. 45 IAC 2.2-5-8 (d) defines the production process as follows:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging if required.

The items are packaged in small groupings within plastic wrap to maintain freshness. The groupings wrapped in plastic are then transported to the boxing area on conveyor belts. The boxes are assembled and moved on a conveyor belt to the packaging area where the product is inserted. The flour corn is a mechanical device that presses the product during placement into the cardboard boxes. The laser printer prints information such as weight, count, supplier, run number, and date directly onto the box.

The customer restaurants require the information printed on the boxes so they know exactly what foodstuffs they are receiving, when and where the foodstuffs were produced, allow discussion of the quality of the product, and to accommodate a recall if necessary. The taxpayer argues that since the restaurants require the labeling, the entire process prior to and including the printing of the information is in the production process. Therefore, according to the taxpayer, the protested items are used in the production process and meet the first prong of the test to qualify for exemption.

The taxpayer's argument is not persuasive. The plastic wrap preserves the freshness of the product. The boxes are merely used for shipping. The information required by the restaurants could be placed on the plastic wrap rather than the boxes. Therefore, the plastic wrap is the last required packaging as contemplated in the regulation. The protested items are used after the completion of the production process and do not meet the first prong of the test for qualification for exemption from the use tax.

Since the protested items do not meet the first prong of the test, it is not necessary to consider the second prong of the test.

Finding

The taxpayer's protest is denied.